

Advisory  
Council on  
Unemployment  
Compensation

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**Collected Findings  
and Recommendations:  
1994-1996**

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## **COLLECTED FINDINGS AND RECOMMENDATIONS: 1994-1996**

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**COLLECTED FINDINGS AND RECOMMENDATIONS:  
1994-1996**

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Reprinted from Annual Reports of the  
Advisory Council on Unemployment Compensation  
to the President and Congress

Advisory Council on Unemployment Compensation  
Washington, DC

1996

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# Advisory Council on Unemployment Compensation

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1. The first part of the document is a list of the names of the persons who have been named in the proceedings. The names are listed in alphabetical order of the last name. The names are: [List of names]

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## Preface

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THE ADVISORY COUNCIL ON UNEMPLOYMENT COMPENSATION was established under the Emergency Unemployment Compensation Act of 1991. The law instructs the Council “to evaluate the unemployment compensation program, including the purpose, goals, countercyclical effectiveness, coverage, benefit adequacy, trust fund solvency, funding of State administrative costs, administrative efficiency, and any other aspects of the program and make recommendations for improvement.”

The Council completed its work in January 1996, after issuing three annual reports. Findings and recommendations on each of the issues that Congress asked the Council to consider are contained in one or more of these reports. In addition, each annual report contains a number of background chapters, summarizing the research findings that informed the Council’s deliberations.

The Council’s first annual report, issued in February 1994, focused primarily on methods for improving the operation of the Extended Benefits Program. In addition, it addressed three issues that Congress specifically requested that the Council consider: use of substate or regional data in triggering the Extended Benefits program, the work search test under Extended Benefits, and taxation of the wages of alien agricultural workers under the Federal Unemployment Tax Act.

The Council’s second report, issued in February 1995, focused on the regular Unemployment Insurance program. It begins with a Statement of Purpose for the UI program and makes recommendations concerning the program’s countercyclical effectiveness, coverage, benefit adequacy, and trust fund solvency.

The Council's third and final report was issued in January 1996. Focused primarily on defining federal-state relations in the UI program, that report begins with a statement that responsibilities and powers should be shared within the Unemployment Insurance program. The report's recommendations suggest methods that could be used to improve the quality and efficiency of the administration of the Unemployment Insurance program.

This compilation contains the findings and recommendations, in chronological order, from the Council's three reports. For easy reference, a double-numbering system is used for the recommendations. The first number is the year of the publication of the report in which a recommendation appeared, and the second number shows the order of that recommendation in the original document. (For example, Recommendation 1994-1 is the first recommendation from the 1994 report.)

For cases in which the Council addressed issues in more than one of its reports, footnotes with asterisks (\*) have been added to the original findings and recommendations noting the location of the additional reference(s). The subject index in this volume provides additional assistance in locating recommendations. Ordering information for the Council's three annual reports appears at the end of this document.

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# 1 / 1994 Findings and Recommendations: Extended Benefits

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## PURPOSE OF THE EXTENDED BENEFITS PROGRAM

The Council finds that the nature of unemployment has changed since the inception of the Unemployment Insurance system. The length of time that individuals are unemployed, which increases sharply during recessions, has also increased slowly but steadily during non-recessionary times. Workers who have been laid off from their jobs are now less likely to return to their previous jobs than has historically been the case. This indicates an increase in the level of long-term unemployment in the economy.

The Unemployment Insurance system was designed primarily as a means of alleviating the hardship caused by short-term unemployment. The system was never intended to combat long-term unemployment. The purpose of the Unemployment Insurance system, and in particular the Extended Benefits program, must be expanded if the system is to deal effectively with the changing nature of unemployment. In doing so, however, careful consideration must be given to the funding of the system, in order to ensure that expenditures for combatting long-term unemployment do not drain the Unemployment Insurance trust fund reserves. It must also be recognized that while Unemployment Insurance reform is a necessary component of developing effective strategies for dealing with long-term unemployment, other reforms—especially among programs for dislocated workers—will be needed.

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NOTE: These findings and recommendations are reprinted from Advisory Council on Unemployment Compensation (ACUC), *Report and Recommendations* (Washington, DC: ACUC, 1994), pp. 7-14.

### **1994-1. Recommendation**

**The scope of the Extended Benefits program should be expanded to enhance the capacity of the Unemployment Insurance system to provide assistance for long-term unemployed workers as well as short-term unemployed workers. Those individuals who are long-term unemployed should be eligible for extended Unemployment Insurance benefits, provided they are participating in job search activities or in education and training activities, where available and suitable, that enhance their re-employment prospects. To maintain the integrity of the Unemployment Insurance income support system, a separate funding source should be used to finance job search and education and training activities for long-term unemployed workers.<sup>1</sup>**

### **THE TRIGGER FOR EXTENDED BENEFITS**

The Council finds that receipt of Unemployment Insurance benefits by the unemployed has slowly but steadily declined since at least 1947—the first year for which data on the system are available. In addition to the long-term downward trend in receipt of benefits, there was a pronounced decline in the early 1980s, just as the economy entered a recession.

The reasons behind the decline in the Unemployment Insurance system are many. The long-term decline appears to have been caused by the changing demographics of the labor force, the changing industrial and geographic composition of employment, and a decline in the solvency of states' Unemployment Insurance trust funds.\* The sharp decline in receipt of benefits in the early 1980s appears to be attributable primarily to changes in federal policies which encouraged the states to increase the solvency of their trust funds by restricting eligibility for Unemployment Insurance benefits and/or increasing employers' tax rates, as well as independent state efforts to improve their trust fund solvency.

The utilization of the Unemployment Insurance system is measured by the Insured Unemployment Rate (IUR). The IUR is the number of Unemployment Insurance recipients, relative to the number of individuals in

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<sup>1</sup> One member of the Council emphasizes that an increase in employers' payroll taxes should not be used as the funding source. Another member emphasizes that such a recommendation must be considered in the context of reform of dislocated workers programs.

\*Additional findings on the long-term decline are included in the 1996 findings (see p. 28).

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UI-covered employment. Since the inception of the Extended Benefits program in 1970, states have been required to use the state IUR as a “trigger” that determines whether or not individuals who have exhausted their regular UI benefits are eligible for Extended Benefits.

Research has shown that the decline in the utilization of the Unemployment Insurance system has caused the IUR to become a less reliable indicator of economic conditions, reducing the likelihood that Extended Benefits will trigger on in states with high unemployment. In addition, just as the IUR was experiencing a marked decline during the recession of the 1980s, the “trigger” level required to become eligible for Extended Benefits was raised.

The combination of the reduction in the IUR and the increase in the trigger level resulted in the failure of the Extended Benefits program to trigger on as unemployment continued to rise during this most recent recession. As a result, Congress found it necessary to pass a series of emergency extensions of Unemployment Insurance benefits. The Council finds that emergency extensions of Unemployment Insurance benefits are extremely inefficient since they are neither well-timed nor well-targeted. Therefore, it is necessary to reform the Extended Benefits program prior to the onset of the next recession, in order to minimize the need for future emergency legislation.

The Council has considered a variety of measures that could be used to trigger the Extended Benefits program. While no perfect measures exist, the best available evidence about the condition of the overall labor market within a state is the Total Unemployment Rate (TUR), which indicates the supply of individuals who are unable to find work. It should be noted, however, that the TUR rates for January 1994 will be affected by the redesign of the Current Population Survey. An alternative measure of the labor market conditions that are faced by Unemployment Insurance recipients is the Adjusted Insured Unemployment Rate (AIUR), which is the IUR adjusted to include those individuals who have exhausted their regular Unemployment Insurance benefits.

The Council finds that while substate (or regional) data are available on some measures of local labor market conditions, these data are extremely unreliable measures of the true conditions that the unemployed face. Furthermore, there would be substantial administrative difficulties in using either substate or regional data for triggering Extended Benefits.

The Council finds that, in addition to problems with the triggers that have been used to determine whether or not Extended Benefits are available within a state, the thresholds built into the triggers have been problematic. These thresholds require that a state’s unemployment rate (whether measured by the

IUR or the TUR) exceed the level that prevailed over the previous two-year period (by a factor of 120 percent for the IUR or 110 percent for the TUR).

The threshold requirements do not significantly affect the number of states in which Extended Benefits trigger on during a recession. However, the thresholds have the effect of delaying the point at which Extended Benefits trigger on in some states with the highest unemployment, as well as hastening the point at which such states trigger off the Extended Benefits program. As a result, the thresholds have caused dissatisfaction among some with the operation of the program since those states suffering the most economic hardship are triggered on for the shortest period of time. This problem could be addressed by eliminating the thresholds and setting the triggers at a slightly higher level.

## **1994-2. Recommendation**

**The Council is unanimous in the view that there is a pressing need to reform the Extended Benefits program.**

The majority of the Council recommends that the Extended Benefits program should trigger on when a state's seasonally adjusted total unemployment rate (STUR) exceeds 6.5 percent as measured before the Current Population Survey redesign.<sup>2</sup> Two members of the Council recommend that each state should have the choice of using either the STUR trigger of 6.5 percent with a threshold requirement of 110 percent above either of the two previous years, or an IUR or AIUR trigger set at 4 percent with a threshold requirement of 120 percent over the previous two year period.

The Council hopes Congress can implement these reforms promptly. Although the Council has reservations about the inefficient targeting of emergency benefits, Congress should extend the existing Emergency Unemployment Compensation for a six month period to provide a bridge program until these Extended Benefits reforms can be implemented.<sup>3</sup>

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<sup>2</sup> Two members of the Council recommend that the trigger should be set at 6.5 percent regardless of any changes in the measured unemployment rate that result from the redesign of the Current Population Survey.

<sup>3</sup> Two members do not agree to the recommendation that Emergency Unemployment Compensation should be extended.

### **1994-3. Recommendation**

**Neither substate nor regional data should be used for the purpose of determining whether or not Extended Benefits are available within a given area.**

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## **FINANCING EXTENDED BENEFITS REFORM**

The Council finds that the integrity of the Unemployment Insurance system as well as its capacity to adapt to the changing nature of unemployment are compromised by incorporating its trust funds into the unified federal budget. While the flow of funds into the Extended Unemployment Compensation account may be adequate to finance the recommended Extended Benefits reform, such reform is complicated by the use of dedicated Unemployment Insurance trust funds for the purpose of deficit reduction. Several members of the Council believe that prompt action should be taken to correct this situation. Other members feel that the issue of how trust fund accounts should be treated in the budget is a very complex one, and requires careful consideration within a broader context. The Council intends to revisit this issue in its future deliberations.\*

### **1994-4. Recommendation**

**If additional revenue is required to implement the Council's recommendations, such revenue should be generated by a modest increase in the FUTA taxable wage base, to \$8,500.<sup>4,\*\*</sup>**

## **WORK SEARCH TEST UNDER EXTENDED BENEFITS**

The Council finds that another problematic aspect of the Extended Benefits program is the federal requirement that, with some exceptions, those individuals who are receiving Extended Benefits must accept a minimum wage job if one is offered, or become ineligible for benefits. While the Council understands that recipients of both regular and extended Unemployment Insurance benefits have an obligation to search actively for work and accept appropriate job offers, the Council finds the current federal requirements to

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\*Recommendation 1995-7 addresses this issue.

<sup>4</sup>Two members object to this recommendation.

\*\*The Council later made an alternative recommendation on this issue (see 1996-20).



be excessively onerous. All states use a “suitability” test to determine the jobs which claimants are required to accept to remain eligible for benefits. This test gives states the flexibility to ensure adequate work search by claimants, while protecting unemployed workers’ living standards and job skills by permitting them to decline substandard jobs. The states are in a better position to determine appropriate mechanisms for enforcing a work search test, given the particular conditions of their labor markets.

#### **1994-5. Recommendation**

**The federal requirement that individuals who are receiving Extended Benefits must accept a minimum wage job if one is offered, or become ineligible for benefits, should be eliminated. Each state should be allowed to determine an appropriate work search test, based on the conditions of its labor market.**

#### **STATE TRUST FUND SOLVENCY**

The Council finds an overall decline in receipt of Unemployment Insurance benefits among the unemployed. This decline is at least partially caused by the inadequate reserves of many states’ trust funds. During the past decade, many states with low or negative trust fund reserves have found themselves in the position of either having to increase taxes on employers in the midst of an economic downturn, or having to take measures to restrict eligibility and benefits for the unemployed. Some believe that this reliance on pay-as-you-go funding has worked to the overall detriment of the Unemployment Insurance system.

The Council believes that it would be in the interest of the nation to begin to restore the forward-funding nature of the Unemployment Insurance system, resulting in a building up of reserves during good economic times and a drawing down of reserves during recessions. The Council finds, however, that any move toward creating federal guidelines for states’ Unemployment Insurance trust fund accounts must be carefully weighed. Otherwise, there will be a risk of creating undue incentives for the states to restrict the eligibility and level of Unemployment Insurance benefits in order to achieve the solvency guidelines. The Council intends to make specific recommendations on this issue in future reports.\*

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\*The Council made recommendations on both solvency and eligibility issues in its 1995 report. Recommendations 1995-3 to 1995-6 address solvency, and Recommendations 1995-9 and 1995-17 to 1995-20 address eligibility.

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### **FUTA TAXATION OF ALIEN AGRICULTURAL WORKERS**

The Council was asked by Congress to consider the treatment of alien agricultural workers within the Unemployment Insurance system. Currently, the wages paid to alien agricultural workers with H2-A visas are exempt from the Federal Unemployment Tax Act (FUTA). This exemption is set to expire on January 1, 1995.

The Council finds that there are arguments both for and against continuing this exemption. Under the current exemption, alien agricultural workers are less costly to hire than domestic workers, on whom FUTA taxes must be paid. This cost differential may create an incentive for substitution of foreign workers for U.S. workers, which argues in favor of repeal of the exemption. Furthermore, the process of certifying workers and issuing H2-A visas imposes costs on the federal and state governments that have the responsibility for overseeing this process. The vast majority (97 percent) of the cost of the certification process is funded through the FUTA tax. Since FUTA serves as the mechanism for funding the costs of the certification process, there is an additional rationale for repealing the exemption of H2-A workers from FUTA taxation.

On the other hand, H2-A workers are ineligible to receive Unemployment Insurance benefits since their visas require that they return to their country of origin within ten days after their employment terminates. Consequently, these individuals cannot meet the “available for work” test of the Unemployment Insurance system. Thus, FUTA taxes would be imposed upon the wages of individuals who cannot receive Unemployment Insurance benefits, which argues against imposing the FUTA tax on their wages.

On balance, the Council finds that the arguments in favor of FUTA taxation of alien agricultural workers outweigh the arguments against continuing that exemption.

#### **1994-6. Recommendation**

**As of January 1, 1995, the wages of alien agricultural workers (H2-A workers) should be subject to FUTA taxes.**

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## 2 / 1995 Findings and Recommendations: Benefits, Financing, and Coverage

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### THE PURPOSE OF UNEMPLOYMENT INSURANCE

The Advisory Council on Unemployment Compensation finds that, although an increasing percentage of the unemployed experience long spells of unemployment, the majority of the unemployed experience relatively short unemployment spells. Similarly, while a growing minority of individuals who receive Unemployment Insurance exhaust their benefits without having found new employment, the majority of individuals receive Unemployment Insurance benefits for a relatively short period of time before returning to employment. This reality dictates that the Unemployment Insurance system must be designed to deal effectively with a variety of needs. In particular, the system must both provide temporary wage replacement to individuals and facilitate the productive reemployment of those individuals who experience longer spells of unemployment.

The Unemployment Insurance system also serves an important macro-economic stabilization role by injecting additional money into the economy during periods of downturn. This objective, however, can only be achieved effectively if the system is forward-funded, thereby accumulating funds during periods of economic health.

These findings lead the Council to a formulation of the following statement of purpose for the Unemployment Insurance system.

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NOTE: These findings and recommendations are reprinted from Advisory Council on Unemployment Compensation (ACUC), *Unemployment Insurance in the United States: Benefits, Financing, Coverage* (Washington, DC: ACUC, 1995), pp. 7-23.

### **1995-1. Statement of Purpose**

**The most important objective of the U.S. system of Unemployment Insurance is the provision of temporary, partial wage replacement as a matter of right to involuntarily unemployed individuals who have demonstrated a prior attachment to the labor force. This support should help to meet the necessary expenses of these workers as they search for employment that takes advantage of their skills and experience. Their search for productive reemployment should be facilitated by close cooperation among the Unemployment Insurance system and employment, training, and education services. In addition, the system should accumulate adequate funds during periods of economic health in order to promote economic stability by maintaining consumer purchasing power during economic downturns.**

### **FUNDING OF THE UNEMPLOYMENT INSURANCE SYSTEM**

The Unemployment Insurance system's capacity to promote economic stability rests on two key aspects of its funding mechanism. First, the funding of the system is "experience rated"—that is, employers who have been responsible for greater demands on the system pay higher taxes and consequently bear a greater share of the system's costs. Second, during periods of prosperity, the system accumulates reserves that are then spent during periods of economic decline.

Some members of the Council believe that experience rating is a crucial component of the program, providing effective incentives for employers to avoid laying off workers. Other members believe that experience rating causes employers to make excessive use of the system's appeal mechanism in an attempt to keep their experience-rated taxes as low as possible. Although the Council was unable to resolve this difference of opinion, it intends to address the issue of experience rating in its next annual report.\*

The Council unanimously concludes, however, that promoting economic stability is an objective that transcends the interests of the states and cannot be achieved by states working in isolation. While some states have attempted to maintain an adequate degree of forward funding, others have not. The

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\*The Council returned to this issue in its 1996 report, but was unable to come to a resolution (see pages 39-40).

low reserves in some states' trust funds weaken the Unemployment Insurance system's capacity to achieve its economic stabilization function.

Effectively promoting the forward funding of the Unemployment Insurance system requires a coherent federal strategy that includes congressionally stated goals.\*

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#### **1995-2. Recommendation**

**Congress should establish an explicit goal to promote the forward funding of the Unemployment Insurance system. In particular, during periods of economic health, each state should be encouraged to accumulate reserves sufficient to pay at least one year of Unemployment Insurance benefits at levels comparable to its previous "high cost." For purposes of establishing this forward-funding goal, previous "high cost" should be defined as the average of the three highest annual levels of Unemployment Insurance benefits that a state has paid in any of the previous 20 calendar years.**

To complement these forward-funding goals, financial incentives to encourage forward funding should be created. This can be done by changing the structure of the interest rates that the federal government pays to the states on their Unemployment Insurance trust fund balances. A slight reduction in the interest rate paid on low levels of states' trust funds could be used to finance a fairly substantial interest rate premium paid on high levels of reserves. While it is difficult to predict with accuracy how many states would respond to such incentives, careful management of the interest rate structure could ensure that these incentives could be financed without additional cost to the federal government.

#### **1995-3. Recommendation**

**To encourage further forward funding, an interest premium should be paid on that portion of a state's Unemployment Insurance trust fund that is in excess of one "high cost" year of reserves. The cost of this interest rate premium should be financed by a reduction in the interest rate paid on that portion of each state's trust fund that is less than one "high cost" year of reserves.**

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\*The Council issued a comprehensive statement of federal-state responsibilities in its 1996 report (see Recommendation 1996-1).

**The U.S. Department of Labor should be given authority to adjust periodically the interest rate structure to ensure that these incentives create no additional cost to the federal government.**

The Council finds that the current federal policy of providing short-term, interest-free loans to state trust funds creates a disincentive for states to forward fund their systems. Preferential loan treatment should be available only to states that have met, or made satisfactory progress toward, the forward-funding goal. An example of how satisfactory progress might be defined is presented in Chapter 5 of this report.

#### **1995-4. Recommendation**

**Preferential interest rates on federal loans to the states should be restricted to those states that have achieved (or made satisfactory progress toward) the forward-funding goal. In particular, the current system of making interest-free, cash-flow federal loans generally available to all states should be ended. Rather, these interest-free loans should be made available only to those states that have achieved (or made satisfactory progress toward) the forward-funding goal prior to the onset of an economic downturn. In other states, these loans should be subject to the same interest charges that are incurred on long-term loans to state Unemployment Insurance trust funds.**

#### **1995-5. Recommendation**

**A method is needed for determining whether a state that has not yet met the forward-funding goal has made “satisfactory progress” toward the goal. This method should be based on an empirical analysis of the rate at which state trust funds must be restored during periods of economic health in order to achieve the forward-funding goal prior to a recession.**

#### **1995-6. Recommendation**

**When states have achieved (or made satisfactory progress toward) the forward-funding goal, yet find it necessary to borrow from the federal government, the interest rate charged on long-term loans**

**should be a preferential rate that is 1 percentage point lower than would otherwise be charged.**

The Council has discussed the level at which the taxable wage base and tax rate established by the Federal Unemployment Tax Act (FUTA) should be set. This is a complex issue. FUTA revenues are earmarked for financing the administration of the nation's Unemployment Insurance system, as well as that of the U.S. Employment Service. However, because the trust funds are currently held within the unified federal budget, it is not possible for these programs to achieve direct access to the funds that are earmarked for them. In addition, a two-tenths surcharge that was imposed in 1977 to pay off trust fund debts has been extended well beyond the time when the debt was repaid. Quite apart from these issues, the Council has not yet made a determination of whether or not additional revenues from FUTA would contribute to more efficient and effective operation of the Unemployment Insurance system and the Employment Service.

Another element of complexity results from the fact that the minimum taxable wage base that the states use for financing their Unemployment Insurance benefits is tied to the FUTA taxable wage base. On average, those states with higher taxable wage bases have a higher level of reserves than do states that have set their taxable wage base at the minimum level of \$7,000. Consequently, raising the FUTA taxable wage base might contribute to the overall forward funding of the system.

Furthermore, a low taxable wage base within a state tends to impose the burden of Unemployment Insurance payroll taxes disproportionately on employers of low-wage workers. To the extent that employers pass on a portion of the tax to their workers in the form of lower wages, therefore, a disproportionate share of the burden of the tax is ultimately borne by low-wage workers. Those low-wage workers who work part-time or part-year, however, are often ineligible for Unemployment Insurance. As a result, the low taxable wage base within the Unemployment Insurance system is both regressive and unfair.

The Council has not yet reached a consensus on how to address these inter-related issues most effectively. As it considers the issues of administrative funding and efficiency over the course of the next year, however, the issue of the FUTA taxable wage base and tax rate will once again be addressed.\*

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\*Relevant recommendations are 1994-4 and 1996-20.



The Council does note, however, that the Unemployment Insurance system was intended as a self-contained system of social insurance. Inherent in this design is the principle that funds are accumulated and held in trust solely for their intended purpose: namely, the payment of benefits to eligible unemployed workers, economic stimulus, and the costs of administering the system.

Inclusion of FUTA accounts and state Unemployment Insurance trust fund accounts within the unified federal budget undermines the integrity of the Unemployment Insurance system. Since federal budget offsets must be identified before additional FUTA funds (which are earmarked for program administration) can be appropriated, some states have found it necessary to divert their trust funds to pay for administrative expenses—expenses that should be paid out of the FUTA trust fund. This diversion, while perhaps necessary, tends to erode the integrity of the system's financing. Employer willingness to contribute to the system, state capacity to develop and maintain adequate trust funds, and worker confidence in the system are all undermined.

Furthermore, when Unemployment Insurance trust fund balances that have been explicitly accumulated for countercyclical purposes are used to balance the annual federal budget, the system loses its capacity to increase spending automatically during recessions. Consequently, unlike other trust funds held by the federal government, the Unemployment Insurance trust funds are rendered fundamentally incapable of achieving one of their major objectives—economic stabilization—through their inclusion in the unified federal budget.

### **1995-7. Recommendation**

**All Unemployment Insurance trust funds should be removed from the unified federal budget.**

### **UNEMPLOYMENT INSURANCE COVERAGE AND TAXATION**

Virtually all wage and salaried workers are covered by Unemployment Insurance, and their employers pay taxes into the system accordingly. There are, however, two important exceptions. The first exception is that nonprofit employers do not pay FUTA taxes, despite the fact that their employees are eligible for Unemployment Insurance, use the system, and generate administrative costs for the system. In calendar year 1992, this exemption cost the federal trust funds approximately \$300 million. The second exception is that agricultural workers on small farms are not covered by Unemployment Insurance. The Council finds no justification for either of these exceptions.

#### **1995-8. Recommendation**

**The FUTA exemption for nonprofit employers should be eliminated.**

#### **1995-9. Recommendation**

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**The exemption of agricultural workers on small farms from Unemployment Insurance coverage should be eliminated.<sup>1</sup>**

The Council also finds that Unemployment Insurance taxes owed by farm labor contractors (“crew leaders”) often are not paid. Federal law specifies that, under most circumstances, these farm labor contractors are the designated employers of their workers and that they are responsible for the payment of Unemployment Insurance taxes. It is difficult, however, to enforce this provision because of the many obstacles that prevent locating crew leaders who have outstanding tax obligations.

#### **1995-10. Recommendation**

**Federal law should be amended so that farm owners or operators are assigned responsibility for unpaid Unemployment Insurance taxes owed by the crew leaders with whom they contract for workers on their farms.<sup>2</sup>**

The Council finds that some employers improperly avoid paying Unemployment Insurance taxes by misclassifying their employees as independent contractors. Clear definitions that delineate the conditions under which an individual would legitimately be qualified as an independent contractor would help to alleviate this problem.

Section 530 of the Revenue Act of 1978 protects businesses that have “reasonable basis” for misclassifying employees as independent contractors. Businesses that fall under the Section 530 “safe harbor” are not required to correct the classification of employees and cannot be assessed back taxes or penalties based on the misclassification of workers. Section 530 also prohibits the Internal Revenue Service (IRS) from clarifying the guidelines for determining whether a worker is an employee or an independent contractor. The ambiguity of these guidelines is the cornerstone of the misclassification prob-

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<sup>1</sup> Two members of the Council object to this recommendation.

<sup>2</sup> One member of the Council objects to this recommendation.

lem and the tax revenue losses associated with it. In addition, revenue collection is limited by Section 3509 of the Internal Revenue Code, which caps the employment tax liability of those businesses not covered by Section 530.

The greatest revenue loss results from businesses that do not file information returns on independent contractors. These are circumstances under which businesses are most likely to misclassify workers, as well as the circumstances under which independent contractors are least likely to report their entire income. Increasing the penalty for failing to file information returns would increase the incentive to file, increase the percentage of independent contractor income reported, and provide the information needed to identify employers that misclassify workers—thereby creating an incentive to classify workers correctly.

While the Council recognizes that correcting these problems would have ramifications that reach far beyond the Unemployment Insurance system, the Council finds that the problems are sufficiently serious to merit action at both the state and federal levels.

#### **1995-11. Recommendation**

States should review and consider adopting the best practices of other states to address classification issues which include the following: clarifying the definitions of employee and independent contractor; specifying employer liability for payroll taxes; licensing, bonding, or regulating the employee leasing industry; and strategic targeting of audits.

#### **1995-12. Recommendation**

Federal law should be amended to eliminate the “prior audit” safe harbor provision of Section 530 of the Revenue Act of 1978.

#### **1995-13. Recommendation**

Federal law should be amended to eliminate the provision of Section 530 of the Revenue Act of 1978 that bars the IRS from issuing guidelines to define the employment relationship.

#### **1995-14. Recommendation**

**Federal law should be amended to repeal Section 3509 of the Internal Revenue Code and to require businesses to pay all taxes owed for workers that are misclassified after the enactment of the repeal.**

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#### **1995-15. Recommendation**

**The \$50 penalty for businesses that fail to file information returns with the IRS or with the independent contractor they have hired should be increased.**

The Council notes that available statistics do not accurately measure the level of Unemployment Insurance receipt among the unemployed (that is, “reciency”). The measure of the “insured unemployed” (IU) and the ratio of insured unemployed to the covered labor force (that is, the insured unemployment rate—the IUR) are frequently used for a number of purposes. When used as measures of reciency, however, they are misleading. Both statistics consistently overstate the number of individuals who actually receive Unemployment Insurance benefits in a given week. In addition to counting recipients, the two measures both include individuals who file a claim for, but do not receive, benefits in a given week (these include individuals on a waiting week, individuals whose claims are ultimately denied for nonmonetary reasons, and individuals who are disqualified for a given week). At the national level, this inclusion has the effect of overstating the number of the unemployed who actually receive Unemployment Insurance benefits by approximately 10 percent (although there is considerable variation among the states in the extent to which currently reported statistics overstate the actual receipt of benefits).\*

#### **1995-16. Recommendation**

**The U.S. Department of Labor should report a measure of Unemployment Insurance reciency. The measure should be a ratio, with the numerator defined as the number of individuals who are actually paid Unemployment Insurance benefits, and the denominator defined as the total number of unemployed individuals.**

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\*Additional recommendations regarding data can be found in 1995-24, and 1996-12 to 1996-15.

### **ELIGIBILITY FOR UNEMPLOYMENT INSURANCE BENEFITS**

Five percent of all workers in 1993 reported that they were unable to find full-time employment, and 16 percent of the work force held part-time jobs. The Council finds that in some states, these individuals are unable to qualify for Unemployment Insurance benefits, even when they have substantial labor force attachment. This problem is especially pronounced for low-wage individuals, many of whom must work in temporary or part-time jobs. Welfare reform could result in an increase in the number of low-wage workers who find themselves in this situation.

Some unemployed workers are unable to qualify for Unemployment Insurance benefits because of their state's definition of the "base period." The base period is the period of time that is used for calculating whether or not unemployed individuals' earnings are sufficient to qualify them for Unemployment Insurance. Many states define the base period as the first four of the past five completed calendar quarters. In these states, therefore, between three and six months of an individual's most recent work experience is excluded from consideration in calculating eligibility for benefits. This may have the effect of disqualifying some workers who have worked continuously, but who need the most recently completed quarter of earnings to be included in the base period in order to qualify for Unemployment Insurance benefits. To solve this problem, some states now use a "moveable base period," which allows the minimum earnings requirement to be met on the basis of the four most recently completed quarters of work if it is not met using the standard definition.

The Council finds that advances in technology have made it feasible for all states to use the most recently completed quarter when determining benefit eligibility, and that using this quarter is consistent with the legislative requirement that states ensure full payment of Unemployment Insurance when due. While the Council has been unable to develop sound estimates of the cost of implementing such a change, there are reasons to believe that the cost may not be prohibitive. First, many of the individuals who are determined to be eligible using a moveable base period would become eligible eventually (as soon as an additional quarter of earnings information becomes available). Second, some of the increase in the cost of Unemployment Insurance benefits would be offset by a reduction in benefits paid under means-tested programs, such as Aid to Families with Dependent Children (AFDC) and Food Stamps.

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In some cases, unemployed individuals cannot qualify for Unemployment Insurance benefits because their eligibility is contingent upon their earnings in the calendar quarter in which they became unemployed. Information about their most recent earnings is typically not available until after the quarter has been completed. These individuals often do not realize that they can reapply (and often qualify) for benefits when information about their most recent quarter of earnings becomes available. This problem could be corrected if these individuals were told when they should reapply for benefits, as well as what additional earnings they would need to qualify for benefits.

#### **1995-17. Recommendation**

**All states should use a moveable base period in cases in which its use would qualify an Unemployment Insurance claimant to meet the state's monetary eligibility requirements. When a claimant fails to meet the monetary eligibility requirement for Unemployment Insurance, the state should inform the individual in writing of what additional earnings would be needed to qualify for benefits, as well as the date when the individual should reapply for benefits.**

In some states, low-wage workers face an additional impediment in qualifying for Unemployment Insurance benefits. In order to meet their state's base period and/or high-quarter earnings requirements, low-wage individuals must work more hours than workers who earn higher wages. For example, an individual who works half-time for a full year (i.e., 1,040 hours) at the federal minimum wage level would not meet minimum earnings requirements in 9 states. At an hourly wage of \$8.00, however, a half-time, full-year worker would be eligible in all states. Similarly, an individual who works two days per week for a full year (approximately 800 hours) at the minimum wage would not meet the minimum earnings requirements in 29 states. At a wage of \$8.00 per hour, however, that individual would be eligible in all but 2 states.

The Council finds that any individual who works at least 800 hours per year should be eligible for Unemployment Insurance benefits and that states' minimum earnings requirements should be set accordingly. If all states set their earnings requirements at this level, the number of individuals eligible for Unemployment Insurance benefits would increase by approximately 5.3 percent, and the amount of benefits paid would increase by approximately 3.6 percent. Some of the increase in the cost to the system, however, would

be offset by a reduction in receipt of means-tested benefits such as AFDC and Food Stamps.

**1995-18. Recommendation**

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**Each state should set its law so that its base period earnings requirements do not exceed 800 times the state's minimum hourly wage, and so that its high quarter earnings requirements do not exceed one-quarter of that amount.**

Fourteen states preclude workers in seasonal industries from collecting Unemployment Insurance except during the season in which work is normally done within the industry. In addition, twelve of these states disallow seasonal workers' earnings from being counted toward their minimum earnings requirement, even if the individual subsequently works in a nonseasonal job. The Council finds these exclusions to be problematic.

**1995-19. Recommendation**

**States should eliminate seasonal exclusions; claimants who have worked in seasonal jobs should be subject to the same eligibility requirements as all other unemployed workers.**

In addition to the monetary requirements for qualifying for Unemployment Insurance, each state has a variety of nonmonetary requirements that unemployed individuals must satisfy in order to qualify for benefits. These requirements include stipulations about availability for suitable work, ability to work, work search requirements, voluntary separation for good cause, discharges due to misconduct, refusal of suitable work, and unemployment as a result of a labor dispute. In some cases, part-time workers (who meet monetary eligibility requirements) are explicitly precluded from receiving Unemployment Insurance.

**1995-20. Recommendation**

**Workers who meet a state's monetary eligibility requirements should not be precluded from receiving Unemployment Insurance benefits merely because they are seeking part-time, rather than full-time, employment.**

State legislation often does not address the specifics of many of the situations that Unemployment Insurance claimants face. As a result, interpretations of nonmonetary eligibility requirements can also be found in administrative and judicial case law and administrative rules. Testimony presented in the Council's public hearings indicates that the complexity of these nonmonetary requirements creates confusion about eligibility requirements. It can be difficult for both claimants and employers to understand these requirements with a reasonable degree of certainty. These problems can be particularly pronounced for multistate employers.

Not only can this lack of certainty impede the receipt of Unemployment Insurance, it may also increase unnecessarily the number of appeals filed by both claimants and employers. These problems appear to be particularly severe with regard to determinations involving employee misconduct, refusal of suitable work, and voluntary leaving for good cause. Clarifying these issues would serve the interests of both groups.\*

#### **1995-21. Recommendation**

**A state-specific information packet that clearly explains Unemployment Insurance eligibility conditions (both monetary and nonmonetary) should be distributed by the states to unemployed individuals.**

The Council is particularly concerned about a number of specific nonmonetary eligibility conditions. For example, it is not always clear whether an individual who is unavailable for shift work (perhaps due to a lack of public transportation or child care) will be found to be eligible for Unemployment Insurance. Consideration needs to be given to situations in which individuals quit their jobs because of one of the following circumstances: a change in their employment situation (e.g., change in hours of work), sexual or other discriminatory harassment, domestic violence, or compelling personal reasons, including family responsibilities. In addition, the Council is concerned about the variability in the definition of misconduct across states, and about the treatment of individuals who refuse employment because it is temporary or commission work. The Council intends to address these and related issues in its third annual report.\*\*

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\*Additional recommendations on this issue can be found in 1996-8 and 1996-10.

\*\*See Recommendation 1996-8.



## **ADEQUACY OF UNEMPLOYMENT INSURANCE BENEFITS**

At the inception of the Unemployment Insurance system, much debate was devoted to the adequacy of benefits. Many of the founders of the system argued that benefits should replace 50 percent of lost earnings; they believed that this percentage was high enough to allow workers to purchase basic necessities, but not so high as to discourage prompt return to work.

A number of presidents, including and following Dwight Eisenhower, have endorsed a goal of 50 percent replacement of lost earnings within the Unemployment Insurance system. President Richard Nixon advocated that the Unemployment Insurance system should seek to replace 50 percent of lost earnings for four-fifths of all Unemployment Insurance recipients.

The level of a state's maximum weekly benefit amount has a direct impact upon the percentage of Unemployment Insurance recipients who receive benefits that equal or exceed a given replacement rate. Those individuals whose earnings qualify them for their state's maximum weekly benefit amount typically have less than half of their wages replaced. Therefore, when a state's maximum benefit amount is relatively low as a percentage of the state's average weekly wage, the state will not meet the 50 percent replacement rate goal for a large percentage of recipients.

The Council endorses the long-standing goal of 50 percent replacement of lost earnings, and notes that a state is likely to be able to achieve this goal for a large number of workers by setting the state maximum weekly benefit amount equal to two-thirds of state average weekly wages.

### **1995-22. Recommendation**

**For eligible workers, each state should replace at least 50 percent of lost earnings over a six-month period, with a maximum weekly benefit amount equal to two-thirds of the state's average weekly wages.<sup>3</sup>**

The Council also notes that, starting in 1986, all Unemployment Insurance benefits became subject to taxation. Taxation of Unemployment Insurance benefits results in a reduction of the effective replacement rate.

### **1995-23. Recommendation**

**Unemployment Insurance benefits should be tax-exempt.<sup>4</sup>**

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<sup>3</sup> One member of the Council objects to this recommendation.

<sup>4</sup> Four members of the Council object to this recommendation.

The Council finds that the current system for reporting the average replacement rate of lost earnings within the Unemployment Insurance system needs to be improved. While the U.S. Department of Labor routinely reports the replacement rate, the concept used in the calculation is flawed. The reported replacement rate is calculated by dividing Unemployment Insurance benefits paid by the wages of all covered workers. To the extent that those who receive Unemployment Insurance have lower wages than the average covered worker, the reported replacement rate will understate the actual replacement rate. Conversely, if those who receive Unemployment Insurance have higher wages than the typical covered worker, the reported replacement rate will overstate the actual replacement rate. Advisory Council calculations using data available from selected states suggest that the reported replacement rate significantly understates the actual replacement rate.\*

#### **1995-24. Recommendation**

**The U.S. Department of Labor should calculate and report the actual replacement rate for individuals who receive Unemployment Insurance. This replacement rate should be calculated by dividing the weekly benefits paid to individuals by the average weekly earnings paid to those individuals prior to unemployment.**

#### **REEMPLOYMENT INCENTIVES**

The Council finds that financial incentives (such as reemployment bonuses or self-employment subsidies) for facilitating rapid reemployment have a positive impact on a small portion of the unemployed. In some cases, this positive impact could be offset partially by negative impacts on others who find jobs more slowly because they are displaced in the job queue by those who receive the incentives. This displacement effect is likely to be more pronounced during periods of relatively high unemployment.

The Council concludes, therefore, that the states should be permitted to experiment with reemployment incentives, but it opposes incentives to encourage (or require) states to implement such strategies.

Some members of the Council object to the use of self-employment incentives within the Unemployment Insurance system—especially when an individual's entire benefit is paid in lump-sum form.

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\*Additional recommendations regarding data can be found in 1995-16, and 1996-12 to 1996-15.

### **1995-25. Recommendation**

**States should be given broad discretion in determining whether reemployment incentives, such as reemployment bonuses or self-employment allowances, should be included as a part of their Unemployment Insurance systems.**

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## **ADMINISTRATIVE FINANCING**

States' administrative costs are financed by the federal government with a portion of the revenues generated by FUTA. This situation requires some systematic method for allocating these revenues among the states. The Council finds that whatever method is chosen, it is important to create financial incentives for states to administer their Unemployment Insurance systems efficiently. For example, those states that are able both to administer their Unemployment Insurance systems with less money than is allotted to them and to achieve U.S. Department of Labor performance requirements could be allowed to keep all or part of the surplus for other uses within their UI systems. The Council intends to address this issue, in conjunction with the U.S. Department of Labor's performance requirements, in its next annual report.\*

The U.S. Department of Labor has proposed an Administrative Financing Initiative (AFI) that would allocate FUTA funds based on a national unit cost with base-level and contingency-level funding. The Council takes no position on the AFI, because the U.S. Department of Labor and the states have not yet agreed on the details of this initiative.

The Council notes that it is inefficient for the federal government to require employers to fill out and submit separate forms and payments for their FUTA and state Unemployment Insurance taxes. Not only does this impose an unnecessary paperwork burden on employers, it also creates redundant tax collection units in the federal and state governments. The expense of collecting Unemployment Insurance taxes could be reduced by allowing the states to collect FUTA taxes on behalf of the federal government.

### **1995-26. Recommendation**

**FUTA taxes should be collected with other Unemployment Insurance taxes by each of the states and submitted to the feder-**

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\*See Recommendations 1996-6 to 1996-8, and 1996-16 to 1996-19, and the findings that precede those recommendations.

**al government for placement in the federal trust fund. States' Unemployment Insurance taxes should remain in the state trust funds, as is currently the case.**

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## 3 / 1996 Findings and Recommendations: Defining Federal and State Roles

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THE NATION'S UNEMPLOYMENT INSURANCE system is based on the sharing of responsibilities between the federal government and the state governments. The Council finds that this framework, which has evolved over 60 years, could be made more effective by implementing changes based on a refined understanding of the appropriate division of responsibilities between the federal and state partners. This finding leads the Council to a formulation of the following statement of federal-state responsibilities in Unemployment Insurance.\*

### 1996-1. Federal-State Responsibilities in Unemployment Insurance

**Unemployment Insurance is a federal-state system of shared responsibilities and powers. These powers and responsibilities should be shared in the most effective possible manner. Whenever appropriate, state governments should assume broad responsibilities for determining the elements of their Unemployment Insurance programs. The federal government should assume responsibility primarily in those areas in which both an essential national interest exists and states' interests may diverge from those national interests.**

**The fundamental objective of the system is the provision of insurance in the form of temporary, partial wage replacement to**

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NOTE: These findings and recommendations are reprinted from Advisory Council on Unemployment Compensation (ACUC), *Defining Federal and State Roles in Unemployment Insurance* (Washington, DC: ACUC, 1996), pp. 7-19.

\*The Council provided a statement of purpose for the Unemployment Insurance system in its 1995 report (see 1995-1).

workers experiencing involuntary unemployment. Federal involvement in this area should limit that competition among states on the basis of Unemployment Insurance costs that undermines the integrity of the system and the capacity of the program to insure workers adequately. A second objective of the system is the accumulation of adequate funds during periods of economic health, thereby promoting economic stability by maintaining consumer purchasing power during economic downturns. The achievement of these fundamental purposes, which serve the national interest and transcend the interests of any individual state, require federal oversight and action.

## **FEDERAL-STATE INTERACTIONS**

### **Federal Responsibility in Areas of Essential National Interest**

As noted above, there are two primary areas of essential national interest that may diverge from state interests: the provision of adequate insurance to workers throughout the country and macroeconomic stabilization. The program's capacity to meet these two fundamental objectives first depends upon the existence of state UI programs, and second, requires the proper functioning of a number of specific program components, each of which can be eroded through the dynamics of interstate competition. The components are enumerated in this section and are discussed in detail in Chapter 3 of this report.

The Council finds evidence that escalating competition among some states to attract and retain business may result in UI tax rates that are lower than they would be without this competition (see Chapter 4 of this report). Reduced state UI taxes frequently result in tightened eligibility standards, which adversely and disproportionately affect low-wage workers. In addition, tax competition could result in reductions in benefit levels or in diminished access to services.

Consequently, to ensure the achievement of the first national objective—the provision of temporary, partial wage replacement to workers experiencing involuntary unemployment—the federal government should act to prevent any potentially destructive consequences arising from interstate competition. Thus, there are two primary areas in which federal involvement is necessary—minimum eligibility and benefit levels, and access to services.

To assure the achievement of the second national objective—the countercyclical stabilization of the national economy—a unified national strategy is required. Thus, it is the responsibility of the federal government to take

action, as necessary, to preserve the four components that enable the program to stabilize the economy during periods of economic downturn. The four components follow. First, state programs should be forward-funded with independent trust funds in order to ensure that the UI system as a whole has the capacity to inject additional money into the economy during recessions and in order to reduce the need to raise taxes during economic downturns.\*

Second, state UI benefit levels should be high enough and should be paid to a large enough percentage of the involuntarily unemployed to support efficient economic stabilization efforts.\*\* Third, the capacity must exist to monitor and analyze national and local labor market conditions consistently and quickly. Fourth, any supplemental mechanism for stabilization (for example, Extended Benefits or contingency administrative funding during times of unusually high unemployment) should be maintained and coordinated at the national level.\*\*\*

Thus, to protect essential national interests, the federal government must take responsibility for protecting specific components of the UI program when autonomous state action might adversely affect the national interest. To preserve the components discussed above, federal involvement is necessary in the seven areas listed in Recommendation 2. In each of these areas, federal requirements should be as clear and as simple as possible.

## 1996-2. Recommendation

**To preserve national interests in the UI system, the federal government should take an active role in the following areas: (1) ensuring the existence of a UI system in each state; (2) promoting the forward funding of the system; (3) monitoring and coordinating the collection of information on labor market conditions; (4) promoting economic stability by maintaining supplemental benefit programs that trigger on automatically during recessions, thereby avoiding the need for costly federal emergency benefits; (5) coordinating the efficient pooling of risk by making loans available to states experiencing prolonged recessions; (6) assuring that all workers with a given level of attach-**

\*The Council made recommendations on forward funding (Recommendations 1995-3 to 1995-6) in its 1995 report.

\*\*The Council made a number of recommendations in regard to eligibility and benefit levels in its 1995 report (see, in particular, Recommendations 1995-9 and 1995-17 to 1995-20).

\*\*\*The Council's recommendations for improving the operation of the Extended Benefits program are contained in its 1994 report (Recommendations 1994-1 to 1994-6).



**ment to the work force are eligible for a minimum level of benefits; and (7) promoting quality and efficiency in program outcomes.**

### **Federal Oversight in Other Areas**

While taking a role in the areas listed in Recommendation 2, the federal government should avoid involvement in program areas in which essential national interests are not at stake. Indeed, in these areas, the federal government should take steps to encourage state experimentation and to enhance state flexibility. Program details in such areas are better left to the discretion of the states, which function more efficiently as “laboratories of democracy” and which may be able to provide better service to their citizens. Thus, federal involvement should exist primarily in those areas in which there are essential national interests at stake.

A number of current federal laws, federal regulations, and federal oversight functions affecting UI do not meet these criteria and should therefore be repealed or discontinued. Included are the following: requirements that the states must disqualify certain categories of workers (for example, professional athletes and school employees who are between terms) and reduce unemployed workers’ UI benefits if they receive certain other types of retirement income; standards that the states must meet in order to qualify for full Extended Benefits funding (for example, the imposition of a waiting week for benefits and requirements that recipients meet stricter definitions of continuing eligibility); and a variety of oversight functions which are discussed below.

#### **1996-3. Recommendation**

**Federal requirements that states disqualify certain categories of workers (for example, professional athletes and school employees who are between terms) should be repealed.**

#### **1996-4. Recommendation**

**Federal requirements that certain types of workers’ retirement income offset UI benefits should be repealed.**

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### **1996-5. Recommendation**

**Federal requirements that states meet certain standards in order to receive full funding for Extended Benefits should be repealed.**

## **ADMINISTRATIVE ISSUES**

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### **Measurement of Performance Outcomes**

Performance measures within the UI system should focus on program outcomes rather than on program processes, since the latter are within the purview of the states. In addition, performance requirements should be confined to areas in which there is both an essential national interest and a potential divergence of national and state interests. There is no need to monitor program inputs or state performance in areas in which state and national interests coincide. Moreover, these areas involve program processes rather than program outcomes, which, as stated, should be the responsibility of the states. Some of these areas, including aspects of benefit payment and revenue collection, are currently regulated by elaborate federal quality control programs (see Chapters 5 and 6).

By selecting only essential measures of performance outcomes, the federal government would underscore the importance of state performance on those particular measures. Currently, the relative importance of various outcomes may be obscured by the large number of performance measurements required of the states. Further, the elimination of unnecessary performance measures should reduce state administrative burdens considerably and would ensure that available resources were dedicated to achieving the outcomes identified as most essential to the functioning of the system. Finally, the selection of clear and easily measured outcomes would promote a better understanding of the Unemployment Insurance system.

The federal government should, however, require the measurement of performance outcomes in essential program areas in which national and state interests may diverge. Some such areas are not currently subject to performance measurement, including forward funding and the ease of claimants' access to the system, which is discussed below.

The Council is aware of the efforts of the Performance Enhancement Work Group, which consists of representatives from the state employment security agencies (SESAs) and the U.S. Department of Labor. This group has been working since 1993 to improve the performance of the UI system by improving the measurement of performance within the system. While this

collaborative effort is commendable, additional work needs to be done on the fundamental issues of forward funding and access to the system.

The Council finds that there would be benefit in undertaking a more fundamental re-engineering of UI performance measurement. Such an effort should be based on careful consideration of the basic objectives of the UI program. Required performance measures, as well as the reports on UI that the U.S. Department of Labor requires of the states, should be designed to ensure that the basic objectives of the system are achieved.

The Council finds that four principles should be applied in shaping an appropriate set of outcomes to be measured within the Unemployment Insurance system. First, the measures should reflect the fundamental purposes of the Unemployment Insurance system. Second, performance measures should focus on the system's outcomes, rather than on the amount of input or the processes by which outcomes are achieved. Third, those measures of performance outcomes that are identified as essential should be as clear and simple as possible. Fourth, the application of these measures of performance should ensure equity in the treatment of both claimants and employers.

#### **1996-6. Recommendation**

**The federal priority in the area of performance measurement should be to ensure that required performance measures emphasize the essential national interests of the UI system. The national interests that could be influenced by the system of performance measurement, but that are not currently incorporated in it, include forward funding and access to the system.**

The current federal emphasis on benefit quality control measures is excessive and should be reduced, because ensuring that benefits are not overpaid should be a state rather than a federal responsibility. Similarly, ensuring that UI taxes are collected when they are due is a state responsibility that can be accomplished with minimal federal oversight. Given that employers' tax rates form a critical part of the nation's statistical system, some federal oversight in this regard is appropriate.

#### **1996-7. Recommendation**

**In cooperation with the U.S. Department of Labor, states should develop, monitor, and report their own measures of the quality of their procedures for UI benefit payment and revenue collec-**

tion, using generally accepted accounting principles and auditing standards.

#### **1996-8. Recommendation**

The U.S. Department of Labor should work in partnership with the states to develop measures of access to the UI system. These measures should include but should not necessarily be limited to the ease with which individuals can apply for benefits and the extent to which individuals with a substantial attachment to the labor force are eligible for benefits.

Factors to be considered in developing measures of the ease with which individuals can apply for benefits should include the following: (1) whether information that clearly explains the application process is readily available, (2) how much time is required to complete the application process, and (3) whether it is possible to apply for benefits in languages commonly spoken by those who are served by the program.

Factors that should be considered in developing measures of access to the UI system include whether individuals with a substantial work history are excluded for any of the following reasons: (1) they have worked in seasonal jobs, (2) their wages are low, (3) their most recently completed quarter of wages was not included in measuring their monetary eligibility, (4) they quit their job for legitimate family-related reasons, (5) they are unable to accommodate an employer's change in job conditions, (6) they are seeking part-time work, or (7) they are unable to accept shift work.

Inadequate or incomplete information about the UI claims or appeals processes among some claimants may have the effect of restricting their access to the UI system. Similarly, a lack of information or understanding among some employers may result in their being charged for illegitimate claims, resulting in higher UI taxes. In its 1995 report, the Council recommended that states distribute an information packet on eligibility requirements to unemployed individuals. Additional state efforts would also help guarantee that all parties interact equitably—"on a level playing field"—within the UI system. These efforts should be directed at ensuring that claimants and employers enter the system with a common understanding of the nature of relevant proceedings.

### **1996-9. Recommendation**

**Each state should establish a mechanism, such as an ombudsman's office, to provide claimants or employers with any requested information on procedures or requirements in the claims or appeals processes.**

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### **1996-10. Recommendation**

**The federal guarantee of a fair hearing should be interpreted to include the unrestricted right of appeals participants to representation of their own choosing. Each state should provide clear notice of this right to all claimants and employers.**

### **1996-11. Recommendation**

**Each state should provide information to claimants and employers on available sources of advice or advocacy assistance.**

## **Data Needs and Reporting Requirements**

Throughout its long history, the UI program has produced a vast amount of information. These UI data are used for a variety of purposes, such as administering the UI program itself, facilitating its interaction with other federal and state programs, and contributing information to the nation's statistical system. For example, the UI tax records and data collected by the states to determine labor force attachment and the earnings of workers cover most of the nation's business establishments and almost all of the nation's workers. These data constitute a large body of administrative information about the labor market and are therefore extraordinarily important.

Individual states use UI information to operate the program, to evaluate efficiencies, and to conduct research on UI issues. The federal UI Service uses the data to monitor the work of the states, to carry out UI research, to administer the system, and to ensure that federal UI program standards have been met. In addition, the Bureau of Labor Statistics (BLS), the statistical arm of the U.S. Department of Labor, relies on the state employment and earnings reports for survey benchmarks, and it uses the UI tax records to form the universe of business establishments for sample surveys.

In spite of these varied uses, little systematic attention has been given to the comparability, accuracy, and completeness of this rich data source. Indeed, the Council frequently found it impossible to obtain comparable state

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data for analyzing many of the questions it addressed. Further, only occasional attention has been given to the format, editing standards, uniformity of data definition, completeness, and ease of computerized access to the base of information that flows from the UI system.

These conditions are not surprising. Until recently, the informational value of administrative data was not universally recognized. Few have understood the need for the precision and quality control that distinguish a statistical database for research purposes from a program database that ensures the delivery of services. Today, data are increasingly used to monitor the economy and to evaluate public policy, and the value of administrative program records as an efficient and cost-effective source of information with minimal need for additional reporting burden cannot be overlooked. To allow fuller utilization of this resource, the quality and comparability of these administrative data should be improved.

Congress has already taken some steps to meet this need. In 1992, it required the BLS to determine procedures for creating a national longitudinal wage record database with information on earnings, establishment and industry classification, and geographic location of employment for all workers covered by the UI system. This improved database will be extremely valuable for research, program evaluation, and statistical purposes.

Nor should other survey-based sources of data about the UI system be overlooked. The BLS-sponsored Current Population Survey (CPS) provides a rich body of information about the U.S. labor force, employment, and unemployment. The UI Service, which has occasionally sponsored special supplements of the CPS, should develop a careful plan for regular periodic supplements to collect detailed information on UI recipients.

Another important survey source of data used for UI research is the Survey of Income and Program Participation (SIPP), conducted by the Bureau of the Census. The SIPP provides an important longitudinal database that includes workers who receive UI benefits, as well as those who participate in other federal and state-sponsored programs. While the SIPP provides much important information about the behavior of UI recipients that is not available elsewhere, many researchers find it unwieldy and extremely difficult to use. It is important that SIPP data be made more accessible.

In summary, the Council finds a need for a systematic and comprehensive system of administrative and survey data about the UI program for use in the following areas: (1) analytical research on the program's outcomes, (2) development of improvements in the program's conceptual design, and (3) enhancement of the country's understanding of the labor market behavior of

workers and employers covered by the program. In addition, there is significant need to improve the quality and timeliness of the UI tax reports, which form the universe for sample selection and the benchmark for many of the nation's most important statistical series. The Council finds that the federal government should be responsible for the design and oversight of a comprehensive UI information system consisting of administrative and survey-based data that are comparable among all states.\*

#### **1996-12. Recommendation**

The U.S. Department of Labor's Unemployment Insurance Service, with advice from the Bureau of Labor Statistics, should design the elements of a comprehensive information system of UI data that are comparable in definition and format for all states. Some of the elements that should be included are data on (1) coverage and eligibility by earnings level and by type of worker; (2) the elements of labor market attachment; (3) the levels and duration of benefits paid; (4) the extent and causes of nonmonetary disqualifications; (5) labor market information at the national, state, and local levels; (6) the extent of forward funding of state trust funds; and (7) the quality, efficiency, and cost of program administration at both the federal and state levels. Each state should maintain its database in accordance with U.S. Department of Labor requirements so that statistical standards, definitional comparability, and easy computer access for all users can be maintained.

#### **1996-13. Recommendation**

The U.S. Department of Labor's Unemployment Insurance Service should continue to plan and sponsor biennial supplements to the Current Population Survey on UI issues.

#### **1996-14. Recommendation**

Because of the importance of the quarterly report on employment and wages (the ES-202 report) to the measurement of the national income and product accounts, and because of the importance of UI tax records to the nation's system of sample surveys, the

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\*The Council made two specific recommendations about data collection in its 1995 report (Recommendations 1995-16 and 1995-24).

**accuracy and statistical quality of these reports must be improved. Giving consideration to costs, the Bureau of Labor Statistics, with advice from the Unemployment Insurance Service, should establish standard procedures that states should follow regarding the development of these data; establish magnetic-media format standards for computer compatibility and accessibility; and establish minimum requirements for editing, data quality, and timeliness.**

#### **1996-15. Recommendation**

**As required by law, the Bureau of Labor Statistics should continue its work on the development of a National Wage Record Database. The Bureau should develop rules to protect the confidentiality of those workers and business establishments included in the database for purposes of research and evaluation. Congress should provide legal protection to ensure this confidentiality.**

#### **Administrative Funding**

The Council finds that the nation's Unemployment Insurance system is subject to downward pressure because of the forces of interstate competition. It is imperative that the federal government exercise leadership to ameliorate these pressures. An important arena for such leadership concerns the method by which the federal government allocates funds under the Federal Unemployment Tax Act (FUTA) to the states for administering the UI system. Indeed, the critical importance of efficient administration was cited by the Committee on Economic Security in 1935 as the reason for originally assigning the cost of state administration of the UI program to the federal government.

The mechanism for allocating FUTA funds to the states for administrative purposes should be as simple as possible, and should provide incentives to promote efficiency and quality in state administration. As currently constructed, however, the system of allocating administrative funds contains no such incentives. Funding levels are based roughly on the expected claims workload, on measures of time (generally based on manual processing) for administrative tasks, and on overhead costs. Under this formula, states with higher costs receive higher levels of reimbursements.

More importantly, the formula provides no direct link between administrative funds and improvements in performance, and there are no overall quality measures related to funding decisions. In the Council's view, states



that provide better services to claimants and employers by improving quality and efficiency should receive financial rewards for doing so. This might be achieved through a number of mechanisms, including the tying of administrative funding levels to state performance in certain essential areas and increasing the federal government's use of challenge or innovation grants to states.

The Council finds that the appropriation of administrative funding on the basis of predicted workloads, reflecting economic conditions and increases in operating costs, is the method that best serves the needs of claimants, employers, and state agencies for reliable and predictable levels of administrative funding. These appropriations should be automatically adjusted to cover the costs of increased workload for claims above the predicted level. The Council affirms its concern that adequate amounts of dedicated FUTA payroll tax revenues be made available to state agencies and to the U.S. Department of Labor for their intended uses, and that appropriations of these funds not be limited by budgetary factors external to the UI system.\*

#### **1996-16. Recommendation**

**Congress should appropriate FUTA trust funds in amounts adequate to fund state and federal UI activities on the basis of workload predictions using economic factors, with a contingency reserve provision to cover the costs of increased workloads arising during a fiscal year.**

#### **1996-17. Recommendation**

**In order to support automation, development of one-stop services, and improvements in customer services, added state administrative funds beyond those needed for base funding should be provided through innovation grants by the U.S. Department of Labor.**

#### **1996-18. Recommendation**

**The U.S. Department of Labor should promptly review its current reporting and oversight requirements, in consultation with the states, and should reduce or eliminate requirements in areas in**

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\*The Council made a recommendation in this regard in its 1995 report (Recommendation 1995-7).

the taxable wage base in real dollars may have the effect of reducing the degree to which the system is experience-rated and forward-funded.

Given these differing perspectives, the Council makes no recommendation with regard to experience rating within the UI system.

With respect to the second key element of the UI system's funding—the accumulation of reserves during periods of prosperity—empirical evidence indicates that, holding all else constant, those states with higher taxable wage bases have higher UI trust fund reserves. Thus, in order to promote the forward funding of the UI system—a federal responsibility—one of the most effective mechanisms is to raise the minimum taxable wage base.\*

#### **1996-20. Recommendation**

**The federal taxable wage base should be raised to \$9,000, with an accompanying elimination of the two-tenths percentage point FUTA surcharge. The federal taxable wage base should be adjusted annually by the Employment Cost Index.<sup>1</sup>**

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\*The Council made another recommendation in regard to the taxable wage base in its 1994 report (Recommendation 1994-5).

<sup>1</sup> Three members of the Council object to the first sentence of Recommendation 1996-20, and five members object to its second sentence.

**which state and national interests are not in conflict or in which federal responsibilities are not directly related to a requirement.**

#### **1996-19. Recommendation**

**States should be given greater flexibility to identify employers for tax auditing. As an incentive for more effective auditing, the federal government should permit states to retain 50 percent of any FUTA revenues that are generated through state's redirected auditing activities.**

### **EXPERIENCE RATING AND FUNDING**

As the Council noted in its second annual report, the Unemployment Insurance system's capacity to achieve one of its fundamental purposes—promoting economic stability—rests on two key aspects of its funding mechanism. First, the funding of the system is “experience rated”—that is, employers who have been responsible for greater demands on the system pay higher taxes and consequently bear a greater share of the system's costs. Second, during periods of prosperity, the system accumulates reserves that are then spent during periods of economic decline.

Empirical evidence indicates that experience rating helps discourage temporary layoffs, thereby lowering the overall level of unemployment. In addition, the evidence suggests that experience-rated taxes are more effective than are flat taxes in influencing employer behavior in this regard. This may be because experience-rated taxes are borne primarily by employers, whereas flat taxes are more easily passed on indirectly to employees or to consumers. By assigning a greater share of the costs of the system to employers responsible for greater demands on it, a system of experience rating allocates costs more equitably among employers. Finally, experience rating gives employers an interest in ensuring that benefits are paid only to individuals who meet the program's eligibility criteria.

Some members of the Council are concerned, however, with a number of aspects of the experience-rating system. First, such a system often imposes costs on firms precisely when they are in the weakest economic position. Second, under a system of experience rating, some employers might make excessive use of the appeals system. There is evidence that employers' appeals rates have increased in recent years and that they are losing a higher percentage of the appeals they file. Finally, the steady decline in the level of

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